DECEMBER 2019

Public to Private Transactions of UK Listed Companies: Navigating the UK Waters

"Despair on the stock exchange over Brexit turmoil.... has severely pushed down the value of domestic UK firms. Coupled with sterling close to historic lows against the dollar it has made some of the UK's best performing and most famous businesses historically cheap for overseas bidders" (The Daily Telegraph, 6 November 2019).

The weak pound, Brexit, and general macro-political uncertainty in the UK has led to increased takeover interest of UK listed companies from potential international acquirers. The recent General Election may have had a positive effect on the markets, but with Brexit now more of a certainty and with trade deals still to be agreed, this takeover interest could be set to continue.

The UK takeover regime does bring particular challenges to take private transactions (or P2Ps). This note explores some of the early stage regulatory issues that arise for potential international acquirers of UK listed companies and how to navigate safe passage through these unfamiliar UK regulatory waters.

1. Basic Takeover Structures

Takeover Offers and Scheme of Arrangement

There are two basic ways to do a takeover of a UK publicly listed company: (i) a takeover offer; and (ii) a scheme of arrangement.

In a takeover offer, the bidder will want to get acceptances for 90% of the target's shares (by number and voting rights) to which the offer relates, following which it can use a statutory squeeze out process in the Companies Act to compulsorily acquire the other 10%.

In a scheme of arrangement (which is a court approved process) the target will hold a shareholders meeting at which shareholders representing: (i) a majority in number; and (ii) 75% in value of the shares eligible to vote will need to approve the scheme. If the scheme is approved by such shareholders and then subsequently the court the bidder will acquire 100% of the shares.

In rough terms, about two-thirds of UK takeovers are done by way of a scheme of arrangement (largely because a scheme is often the easiest way to get 100% of the target's shares). A scheme of arrangement is normally only used where an offer has been recommended by the target's board, as the court approval process is initiated by the target.

Undertakings to Support the Bid Acceptances

Prior to announcing a takeover, a bidder will usually obtain an "irrevocable undertaking" from key shareholders/managers/directors. An irrevocable undertaking is a binding undertaking by the particular shareholder in favour of the bidder to accept the takeover offer or vote in favour of the scheme (depending on which structure is being used).

Irrevocable undertakings take several forms: (i) a 'hard' undertaking – which will bind the particular shareholder regardless of whether a competing or higher offer emerges; (ii) a "hurdle" undertaking – which will bind the particular shareholder until a higher offer emerges (typically in excess of 10% or more) which is not then matched or bettered within a specified time frame; and (iii) a "soft" undertaking – which will bind the particular shareholder until a higher offer emerges (regardless of hurdle).

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2. The Initial Approach – Points for the Bidder

Prior to making any initial approach, proposed bidders should bear in mind that the preservation of secrecy is paramount. Knowledge of a potential transaction must be restricted to a defined small group of persons.

To avoid a false market being created in the target's shares, the Takeover Panel (the Panel) are likely to require an announcement to be made: (i) following an untoward movement in the target's share price (typically 5% intraday or 10% since the commencement of talks); or (ii) in case of rumour and speculation in the market.

As a general rule, the bidder is responsible for making such an announcement following an initial approach and prior to a formal approach being made. It is therefore obliged to monitor the share price of the target at this stage. Responsibility for making this announcement shifts to the target following receipt of the formal approach. Any announcement requires the identity of the bidder to be disclosed and places the target in an "Offer Period", triggering the 28 day "put up or shut up" rule (PUSU) – please see below.

The Panel must be consulted by a bidder's financial adviser prior to more than six external parties being approached about an offer or possible offer, for example shareholders or potential providers of finance (debt or equity) (this is commonly known as the Rule of 6).

In a consensual process, the due diligence process will be run by the target's board (or an independent committee of such board). It should be remembered that any information disclosed to one bidder has to be disclosed to other bidders, save in the case of disclosures made to a bidder in respect of a formal sales process (see below).

3. "Put up or Shut up"

An important rule is the "put-up-or-shut-up" rule that was implemented in 2011 in response to the Kraft / Cadbury takeover. It requires a bidder for a UK-listed company to make a formal offer for a target within 28 days after its intentions become public—either from market rumours or from notice by the target company—or face a six-month standstill. If the target company wants to continue to engage in negotiations with the would-be acquirer at the end of the 28 day period, the companies can jointly request an extension from the Panel.

The rule, designed to prevent UK listed companies from facing the disruptive impact of prolonged takeover speculation, has had several material consequences on public M&A tactics:

- It has forced bidders to come to the table better prepared and be able to move faster, as unprepared bidders can be forced to abandon interest - bidders need to be ready and able to complete both diligence and their financing arrangements in order to reach a deal within a 28 day period.
- Target companies have gained negotiating leverage through the ability to respond slowly and force the bidder to bid against itself or face a prolonged standstill period.
- As marketplace rumours force previously confidential dialogue into the public domain, the rule encourages competitive bidders to emerge prior to reaching a formal deal.

4. Management Shareholders

Sometimes management will own shares in the target company which are material in the context of an offer. Under the Takeover Code all target shareholders have to be treated equally. Therefore, if management wish to roll over their shares into shares of the bidder then either: (i) all target shareholders must be offered the same opportunity to take equity in the bidder (which may result in the financial sponsor having to accommodate unwanted minority shareholders in the bidder); or (ii) independent shareholder approval must be obtained to management being treated differently and in such circumstances, shares being rolled over into the bidder vehicle cannot count towards acceptances received. The other structural alternative is for the Panel to agree that those "rolling over" can be treated as joint bidders with the financial sponsor – this is not an easy test to satisfy.

For these reasons, great care needs to be taken before any discussions take place around management's future interests in the bidder. There have been a number of deals where management shareholders cash out as part of the takeover with no legally binding commitment that they will have equity in the buyer group in the future. Rather, it is taken on trust that the bidder will facilitate access to a future or existing incentive plan at some point in the future.

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It is worth noting that if management own a material interest in the target, a financial sponsor may be able to secure significant deal certainty by negotiating with management either a hard irrevocable undertaking or a hurdle irrevocable undertaking to accept the offer.

5. Certain Funds

It must be remembered that a formal offer can only be made when there are “certain funds” in place to satisfy the cash consideration. This means that all financing needs to be in place on an unconditional basis at the time the offer is announced.

Potential acquirers who are able to write an equity cheque for the purchase price from available funds are therefore placed at a considerable advantage in the process, as if their interest is announced and they become subject to a PUSU they are not under pressure to put third party financing in place within the statutory 28 day period.

6. Regulation and Panel Consultation

UK takeovers are primarily regulated by: (i) the UK Takeover Code (the Code), which is administered by the Panel; and (ii) the Companies Act 2006.

It is important to remember that the UK system of takeover regulation is principles-based. The Panel will seek to ensure that the six General Principles (here) which form the cornerstone of the Code are respected in all cases, and an understanding of the principles is essential to navigate the regime.

Consultation with regulators on takeover bids is not typical nor always helpful under many regulatory regimes. In the UK by contrast, consultation is customary. Derogations, dispensations and waivers are possible from many Code rules subject to consultation with the Panel.

7. Formal Sales Processes

Some target companies which have resolved to put themselves up for sale may seek the consent of the Panel to put themselves in what is known as a “formal sales process” (FSP). This tactic (whilst traditionally used for companies in financial distress) is now increasingly being deployed by healthy target companies to encourage competing bids and drive up valuations.

The implications of such a process for a bidder who decides to participate (and there is no obligation for a bidder to participate) are that: (i) there is no obligation for such bidder to be publicly identified as having made an approach (and as such the target board is able to facilitate a due diligence exercise by potential suitors without having to publicly name them); (ii) the 28 day PUSU deadline to announce a firm intention to make an offer does not apply to such parties; and (iii) subject to prior Panel consultation, the target company is permitted to agree a break or inducement fee with a bidder which had participated in the FSP (provided that the fee does not exceed 1% of the transaction value) – such a fee is otherwise prohibited outside a FSP.

8. Other Points to Note

While P2Ps may offer excellent opportunities for international acquirers, deal teams should be aware of the Panel’s increasing focus on a bidder’s intentions regarding the target’s business. Any plans for closures and lay-offs must be disclosed when a bidder announces its firm intention to make an offer. A bidder must also detail its intentions in respect of the location of the target’s headquarters, any research and development function, pension funds, and any redeployment of the target’s fixed assets. One year after completion of an acquisition, a bidder must confirm to the Panel whether or not it has taken the intended course of action, and publish that confirmation. Bidders must be mindful of potential reputational damage if post-offer intentions are not met.

Winston & Strawn’s lawyers are available to assist with any questions you may have regarding these issues. For further information, please contact the Winston & Strawn lawyer with whom you usually work, or the following lawyers in London listed on the next page.

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